



► **IMPORTANT NOTICE** ◀

ABOUT ARIZONA FORM 140PY

FOR 2003

**CHANGES THAT AFFECT TAXPAYERS CLAIMING
DEPRECIATION EXPENSES AND/OR INTERNAL
REVENUE CODE § 179 EXPENSES HAVE BEEN MADE
TO FORM 140PY AND INSTRUCTIONS**

THE CHANGES ARE EXPLAINED IN THIS INSERT

RECENT ARIZONA TAX LAW CHANGES AFFECTING INDIVIDUALS

The Arizona legislature passed and Governor Napolitano has signed the annual Internal Revenue code conformity bill (SB 1389) which makes changes affecting tax years beginning from and after December 31, 1999. Arizona conforms but makes specific additions and subtractions that have the effect of not conforming to the increased IRC Section 179 expense limitation and the 30% and 50% bonus depreciation provisions of IRC Section 168(k).

- Specifically, for § 179 expenses, there is an addition for any amount claimed on the federal return in excess of \$25,000 and a subtraction to be taken in the year of the expense and each of four succeeding years equal to 20% of that addition.
- The bonus depreciation is handled via an addition equal to all depreciation expense claimed on the federal return and a subtraction equal to the amount of depreciation calculated as if bonus depreciation had not been elected for federal purposes.
- There is also now a subtraction available in the year of disposition of an asset for any difference between federal basis and Arizona basis due to the difference in bonus depreciation treatment.
- The retroactive recognition of the change in depreciation methods (and the basis difference in case of disposition) is to be handled in one of two ways at the election of the taxpayer:
 - 1) recognize the entire cumulative effect of the retroactive change of depreciation methods on the tax return for the first tax year ending on or after December 31, 2003. To qualify for this election, all returns prepared pursuant to the prior law must be filed by the due dates for those returns, including extensions, or April 15, 2004, whichever is later.

– or –

2) amend each of the affected returns individually.

- The statute of limitations is suspended to allow taxpayers to claim refunds resulting from retroactive conformity to the provisions of the Military Family Tax Relief Act of 2003. A taxpayer that was able to file an amended federal income tax return to exclude the gain on the sale of a home because of changes to federal law under the Military Family Tax Relief Act of 2003, may also file an amended Arizona return to exclude that gain. If the amended return is for a tax year prior to 2000, you have until November 10, 2004 to file that return. When filing an amended return under this provision, write “Military Family Tax Relief Act” in red at the top of Form 140X.

FORMS 140A and 140EZ

- Not affected

FORM 140

- Put the addition for § 179 expenses in excess of \$25,000 on line B11 and the subtraction for the recovery on line C28.
- Put the addition for 100% of the federal depreciation claimed on line B9 and the subtraction for the recalculated Arizona depreciation on line C23.
- Put the basis adjustment in the year of disposition on line C28.
- If the taxpayer elects to recognize the entire cumulative effect on the 2003 return, put the net adjustment on line B12 or line C28 as appropriate.

FORM 140NR

- Put the addition for § 179 expenses in excess of \$25,000 on line C19 and the subtraction for the recovery on line D30.
- Put the addition for 100% of the federal depreciation claimed on line C18 and the subtraction for the recalculated Arizona depreciation on line D30.
- Put the basis adjustment in the year of disposition on line D30.
- If the taxpayer elects to recognize the entire cumulative effect on the 2003 return, put the net adjustment on line C19 or line D30 as appropriate.

FORM 140PY

- Put the addition for § 179 expenses in excess of \$25,000 on line C23 and the subtraction for the recovery on line D35.
- Put the addition for 100% of the federal depreciation claimed on line C22 and the subtraction for the recalculated Arizona depreciation on line D35.
- Put the basis adjustment in the year of disposition on line D35.
- If the taxpayer elects to recognize the entire cumulative effect on the 2003 return, put the net adjustment on line C23 or line D35 as appropriate.

FORM 140X

If the taxpayer elects to amend each affected year separately to effect these changes, put the adjustment(s) on line 19 or line 21 as appropriate and include explanations of the changes in PART III.

The text of the bill that made these changes can be found at

<http://www.azleg.state.az.us/FormatDocument.asp?inDoc=/legtext/46leg/2r/laws/0196.htm>

SPECIFIC CHANGES TO ARIZONA FORM 140PY FOR 2003

Revisions to Form 140PY

Page 2, Line C22 is now "Total depreciation included in Arizona gross income."

Revised Instructions for Form 140PY

Line C22 - Total Depreciation Included in Arizona Gross Income

Enter the amount of depreciation deducted on the federal return that is included in Arizona gross income. If you make an entry here, also see the instructions for line D35, "Other Subtractions From Income".

Line C23 – Other Additions to Income

P. I.R.C. § 179 Expense in Excess of Allowable Amount

Enter the amount of IRC § 179 expense included in your Arizona gross income that exceeds \$25,000. If you make an entry here, also see the instructions for line D35, "Other Subtractions From Income".

Line D35 – Other Subtractions

P. Recalculated Arizona Depreciation

Figure the total amount of depreciation allowable pursuant to IRC § 167(a) for the taxable year calculated as if you had elected not to claim bonus depreciation for eligible properties for federal purposes. Enter the amount that is attributable to income taxable by Arizona.

Q. Basis Adjustment for Property Sold or Otherwise Disposed of During the Taxable Year

With respect to property that is sold or otherwise disposed of during the taxable year by a taxpayer who has complied with the requirement to add back all depreciation with respect to that property on tax returns for all taxable years beginning from and after December 31, 1999, enter the amount of depreciation that has been allowed pursuant to IRC § 167(a) attributable to income taxable by Arizona to the extent that the amount has not already reduced Arizona taxable income in the current or prior years. (Note: The practical effect of this is to allow a subtraction for the difference in basis for any asset for which bonus depreciation has been claimed on the federal return.) A part-year resident may subtract only that amount that is attributable to income subject to Arizona tax.

S. Adjustment for IRC § 179 Expense Not Allowed

Enter 20% of the amount entered on line C23 for excess I.R.C. § 179 expense. This same amount can be subtracted in each of the following four taxable years also, effectively amortizing the difference in treatment over five years.

T. Adjustment for Cumulative Retroactive Change of Depreciation Methods

Arizona tax laws pertaining to depreciation were changed retroactively effective May 7, 2004. These retroactive changes affect tax years beginning from and after December 31, 1999.

The primary effects of the changes are to property for which you claimed "bonus depreciation" on the federal return. The prior method of adding back the amount of the bonus depreciation in the year of acquisition of the property and then subtracting an additional 3/7 of the ordinary depreciation on that property each year is no longer the treatment required (or allowed) by law. The current treatment is described in the instructions for Lines C22 and D35.

This change in method must be applied to depreciation for all tax years ending after August 31, 2001. You must amend each of those years to effect the changes or you may elect to recognize the entire cumulative effect of the change on the tax return for the first tax year ending on or after December 31, 2003 (the 2003 return). To qualify for this election, all returns prepared pursuant to the prior law must be filed by the due date for those returns, including extensions, or April 15, 2004, whichever is later.

Enter the net amount of this cumulative effect that is attributable to income subject to Arizona tax on Line D35 if the election is made. This will include the adjustment to basis (if any) for property that was disposed of during this retroactive period. (If the recalculated cumulative Arizona depreciation is less than the amount previously claimed on the Arizona returns, enter the net amount attributable to income subject to Arizona tax on line C23).

If you do not make the election to recognize the cumulative effect on the 2003 return, you must file an amended return for each affected year and make no entry on Line D35.

NOTE: These revisions were made due to retroactive law changes.

Items of Interest for 2003 (Rev 5/04)

Line Added for Elective Subtraction of Federal Retirement Contributions

Arizona Forms 140, 140PY, and 140NR now have a line for an elective subtraction of federal retirement contributions. This line applies only to individuals who were civilian employees of the United States Government during 2003. The Court of Appeals held that Arizona's taxing scheme for years after 1990 did discriminate against federal employees by taxing their retirement plan contributions but not those of state and local employees. The department has appealed that determination to the Arizona Supreme Court, so the issue is not yet final.

On your 2003 return, you have two options for remedy. You may file the protective claim form or you may subtract the amount of contributions to your retirement plan that was withheld from your wages paid by the federal government.

Depreciation

Arizona law with respect to depreciation was changed. Now, all taxpayers must add the amount of depreciation allowed under I.R.C. § 167(a). Taxpayers must then compute depreciation for Arizona purposes as if bonus depreciation had not been elected for federal purposes. All taxpayers that claim depreciation on the federal return must add that depreciation to Arizona gross income on the Arizona return and then take a subtraction for the allowable Arizona amount. This change was retroactive and applies to taxable years beginning from and after December 31, 1999. This provision will really affect taxpayers that depreciated luxury autos and will allow taxpayers to depreciate luxury autos for which the taxpayer has claimed federal bonus depreciation using the same depreciation rate that would have been allowed if the taxpayer had not claimed bonus depreciation. Affected taxpayers will be able to amend a prior year return to make this adjustment, or as an alternative, the taxpayer may elect to recognize the entire cumulative effect of the retroactive change on the tax return for the first taxable year ending on or after December 31, 2003 (the 2003 return) instead of recognizing the changes on those prior year returns.

Basis Adjustment for Property Sold or Otherwise Disposed of During the Taxable Year

A taxpayer may now claim a subtraction to reflect the difference in federal and state basis of bonus depreciation property when that property is sold. This change was also retroactive to taxable years beginning from and after December 31, 1999. A taxpayer may file an amended return to make this adjustment for a prior year, or as an alternative, the taxpayer may elect to recognize the entire cumulative effect of the retroactive change on the tax return for the first taxable year ending on or after December 31, 2003 (the 2003 return) instead of recognizing the changes on those prior year returns. (Note: The practical effect of this is to allow a subtraction for the difference in basis for any asset for which bonus depreciation has been claimed on the federal return.)

I.R.C. § 179 Expense

For Arizona purposes, you must add the amount of federal section 179 expense deducted in excess of twenty-five thousand dollars to Arizona gross income. You may then take a subtraction for 1/5 of the amount in excess of \$25,000 in the current year and in each of the following four taxable years. This will effectively amortize the difference in treatment over five years. If you have already filed your 2003 return using a different method to deduct I.R.C. § 179 expenses in excess of \$25,000 you will have to file an

amended Arizona income tax return to add the amount in excess of \$25,000 to Arizona gross income and to take a subtraction for 1/5 of the amount in excess of \$25,000.

Military Family Tax Relief Act of 2003

If you were able to file an amended federal income tax return to exclude the gain on the sale of your home because of changes to federal law under the Military Family Tax Relief Act of 2003, you may also file an amended Arizona return to exclude that gain. If the amended return is for a tax year prior to 2000, you have until November 10, 2004 to file that return. When filing an amended return under this provision, write "Military Family Tax Relief Act" in red at the top of Form 140X.

Incarcerated Individuals no Longer Allowed the Increased Excise Tax Credit

Beginning with the 2003 taxable year, a person that served at least 60 days in a county, state or federal prison during the tax year is no longer eligible for the increased excise tax credit.

Dollar Limit of Clean Elections Fund Tax Credit Increased

The Secretary of State adjusted the various Clean Elections Act dollar amounts. The maximum allowable amount for purposes of the Clean Elections Fund Tax Credit is now 20% of the tax liability or \$550 (\$1,100 for married couples filing jointly) whichever is greater.

Wheels to Work Credit Repealed

In 1998, legislation passed establishing the Wheels to Work Program, which included the wheels to work income tax credit. However, in 2002 due to lack of funding, the program was phased out. To conform to the elimination of program funding, Laws 2003, Ch. 61, § 5 repealed the wheels to work credit.

Recycling Equipment Credit Repealed

The recycling equipment credit allowable to individuals has been repealed. You may not take this credit for taxable years beginning January 1, 2003 or later. However, the repeal did not affect any credit carryover that accrued prior to the repeal.

Extra Curricular Activities for the Purpose of the Public School Tax Credit Clarified

The legislature amended the definition of extra curricular activities. Extra curricular activities now include in-state or out-of-state trips that are solely for competitive events. However, extra curricular activities do not include any senior trips or events that are recreational, amusement or tourist activities.

The Arizona Income Tax Treatment of Estates, Trusts, and Beneficiaries of Estates and Trusts Now Conforms to the Federal Income Tax Treatment

Senate bill 1043 (Laws 2002, Chapter 130) amended A.R.S. Title 43, Chapter 13, relating to income taxation of estates and trusts. For taxable years beginning from and after December 31, 2002, the Arizona income tax treatment of estates, trusts, and beneficiaries of estates and trusts will conform to the current federal income tax treatment under the Internal Revenue Code. Additionally, the legislation defines resident and nonresident trusts for purposes of the Arizona income tax. For more information, see Arizona Form 141AZ, *Arizona Fiduciary Income Tax Return*.